

DEPARTMENT OF DEFENSE



Cost Reduction Report

MEMORANDUM FOR THE PRESIDENT—JULY 12, 1965
 DEPARTMENT OF DEFENSE COST REDUCTION PROGRAM
 THIRD ANNUAL PROGRESS REPORT



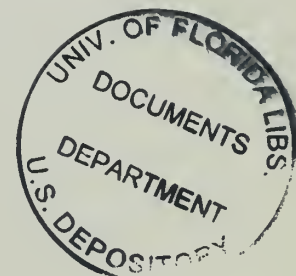
Press Conference, July 14, 1965, The Pentagon, Washington, D. C.

"There is no necessary conflict between the need for a strong defense and the principles of economy and sound management. If we are to remain strong—

- outmoded weapons must be replaced by new ones,*
- obsolete equipment and installations must be eliminated,*
- costly duplication of effort must be eliminated."*

PRESIDENT LYNDON B. JOHNSON,

"Special Message on the Defense Budget," January 18, 1965



THE SECRETARY OF DEFENSE
WASHINGTON

12 July 1965

MEMORANDUM FOR THE PRESIDENT

SUBJECT: Department of Defense Cost Reduction Program—Third Annual Progress Report

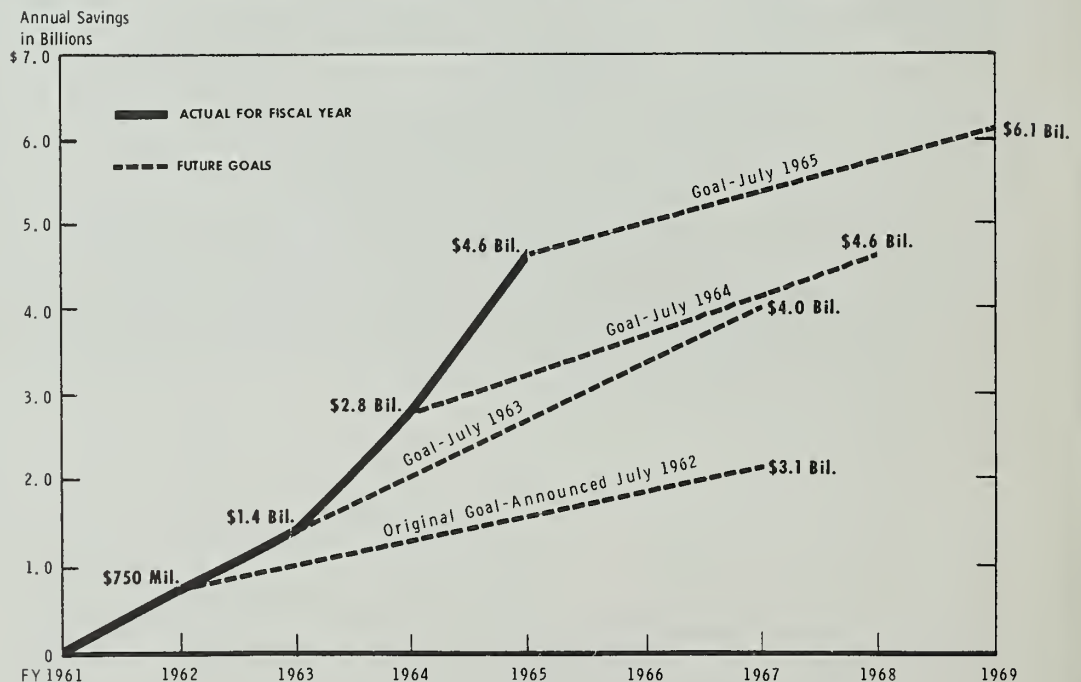
It is again time to report to you on the progress being made by the Department of Defense in improving operating efficiency and reducing costs. Having completed my review of the results achieved during Fiscal Year 1965 and the prospects for further improvements in the years ahead, I find that both are greater than forecast last year:

Savings of \$4.6 billion were actually realized during FY 1965, \$2.1 billion more than estimated.

Savings of \$6.1 billion a year by FY 1969 and each year thereafter have been set as our new long-range goal—an increase of \$1.5 billion per year over the previous objective.

This is the third successive annual increase in the long-range goal:

PROGRESS OF DoD COST REDUCTION PROGRAM



Again, I want to assure you that these savings are being accomplished without any adverse effect on our military strength and combat readiness. Indeed during the last four years we have achieved:

- a 200% increase in both the number and total megatonnage of nuclear weapons in the strategic alert forces
- a 67% increase in the tactical nuclear weapons deployed in Western Europe
- a 45% increase in the number of combat-ready Army divisions
- a 51% increase in the number of tactical fighter squadrons
- a 100% increase in airlift capability
- a 100% increase in general ship construction and conversion to modernize the Fleet
- A 1,000% increase in the Special Forces trained to deal with counter-insurgency threats.

Most encouraging for the future is the fact that more and more of the new opportunities for savings are being originated by the people responsible for carrying out the Program—our military and civilian personnel and our major contractors. This, of course, has always been a basic objective of the Cost Reduction Program. Our day-to-day logistics operations involve the actions and decisions of literally hundreds of thousands of people employed by the Defense Department and its contractors. These people must be properly motivated and provided with a continuing stimulus and incentive for efficiency and economy.

Within the Defense Department, the Cost Reduction Program has been carefully planned and thoroughly organized:

1. It is being vigorously supported by the entire management of the Department, from the highest on down to the lowest managerial level.
2. Firm, clearly defined goals have been set for each level of management and the objectives, methods and procedures of the Program have been explained to and accepted by the people who have to achieve the goals.
3. A uniform and effective system of progress reporting has been established to ensure adequate follow-up on performance.
4. Both the goals and the results are being thoroughly audited by an independent group to ensure that the savings being reported are valid and can be properly substantiated.

I had originally suggested to the Comptroller General that the General Accounting Office undertake the auditing task. For good and sufficient reasons, he thought it would be inappropriate for his office to do so. I, therefore, assigned the task to the Comptroller of the Defense Department. Under his direction, some 200 man-years of auditing effort is devoted annually to the review and verification of the quarterly reports of savings submitted by the logistics managers. All claims of savings which do not meet the established criteria are eliminated before the final report is submitted to me. Accordingly, the savings I am reporting to you have been fully substantiated.

In this connection, it is interesting to note that the Cost Reduction Program was one of the major factors accounting for the drop in Defense expenditures below the amounts originally estimated for both 1964 and 1965. A detailed analysis of expenditures for these two fiscal years reveals that refinements of requirements and lower purchase prices, alone, have reduced expenditures by approximately one-half a billion dollars in each year, over and above the cost reduction savings anticipated in the budgets submitted to the Congress.

This Program, which is helping us to provide the required military strength at the lowest possible cost, has three parts:

1. Buying only what we need to achieve balanced readiness.
2. Buying at the lowest sound price.
3. Reducing operating costs through termination of unnecessary operations, standardization and consolidation.

The following discussion highlights some of the actions taken and the savings achieved during the past year:

I. BUYING ONLY

WHAT WE NEED

The logistics cycle starts with the calculation of requirements and it is at this point that the future cost of the entire logistics system is largely determined. Once we buy more than we need, a whole sequence of unnecessary expenditures is set in motion—inventories are acquired which are never used, more transportation is needed to move them, more storage space to house them, and more people to handle them. Finally, years later, large surpluses must be sold with a return to the Government of less than seven cents on the dollar. Although excess stocks resulting from past procurements have been reduced in recent years, they still amount to over \$10 billion.

Last year we made a comprehensive analysis of our requirements in a number of high cost materiel categories. As a result, savings realized in FY 1965 from “buying only what we need” rose to almost \$2.5 billion compared with \$1.5 billion in FY 1964. Some of the ways in which these savings were achieved are described below.

A. Refining Requirements of Calculations

By a more precise analysis of the combat effectiveness of individual weapons in relation to the targets to be attacked, and by the use of more realistic wearout, loss and pipeline factors, the Services were able to make significant reductions in major weapons and equipment requirements:

1. A detailed review and analysis of a wide range of Navy non-nuclear ordnance items—relating inventory requirements to the activity rates reflected in the war plans and emphasizing the more effective modern types—resulted in savings of \$421 million.
2. An Army study of the factors used to compute the reserve stocks needed to replace high value equipment withdrawn from operation for repair reduced the “maintenance float” for avionics items by one-quarter and for fire control items by one-half—with a savings of \$4.1 million.
3. By furnishing replacements for MINUTEMAN missile guidance sets directly from the specialized repair facility instead of through a warehousing system, the Air Force was able to reduce the stock level for spare guidance sets from 62½ days to 17½ days of consumption—with a procurement savings of \$28.8 million in FY 1965.

REFINING REQUIREMENTS

REDUCTION OF MAINTENANCE SPARES

Army equipment reductions resulted from:

Less maintenance turn-around time
Improved technology
Improved preventive maintenance by user

RESULT OF ANALYSIS

EXAMPLE -



RADIO SET
AN/ARC-54

18 Avionics Items

Before:
SPARE ITEMS 20% OF
INITIAL AUTHORIZATION

After:
REDUCED TO 15%

FY 1965 SAVINGS
\$3,190,876

EXAMPLE -



FIRE CONTROL COMPUTER
M-18

3 Major Fire Control Items

Before:
SPARE ITEMS 10% OF
INITIAL AUTHORIZATION

After:
REDUCED TO 5%

FY 1965 SAVINGS
\$947,646

FY 1965

TOTAL SAVINGS \$4,138,522



ARMY MATERIAL COMMAND AND
DCS LOG

REFINING REQUIREMENTS

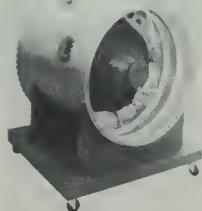
MINUTEMAN GUIDANCE SET

FUNCTION-GUIDES MISSILES TO TARGET

BASE & DEPOT STOCKS ELIMINATED BY:

- USE OF PREMIUM TRANSPORTATION FOR REPAIR AND RETURN
- LOCATING SETS AT MISSILE SITES

30 DAYS STOCKAGE 15 DAYS STOCKAGE 17½ DAYS STOCKAGE



BASE

DEPOT

REPAIR

21 SETS

11 SETS

UNIT COST: \$898,592

FY 1965 SAVINGS \$28,755,000


By reducing, in some cases by half, the time required to procure, deliver and repair replacement parts; by discarding old concepts under which, for some parts, up to twice the quantity actually needed was kept as an insurance reserve; and by basing forecasts on the proven reliability and durability of components and parts—the Services were able to make large reductions in inventory requirements for such items. Actions in this category number in the hundreds and apply to tens of thousands of the items in our supply systems. The following are but a few examples:

1. The Navy, by shortening “pipeline” time, was able to reduce stocks of high value aircraft spares aboard its carriers from 180 days of supply to 90 days with a saving of \$11.0 million.
2. The Air Force, by reducing the repair time on a large number of replacement parts, was able to reduce the inventory pipeline with a saving of \$80.5 million.
3. The Defense Supply Agency, by reducing the procurement leadtime on small electric light bulbs from six months to a much more realistic two months, was able to reduce stock levels and make a saving of \$194,289.

**REFINING
REQUIREMENTS**

CLEAR LIGHT INCANDESCENT LAMP

USED TO ILLUMINATE AIRCRAFT AND FIRE CONTROL INSTRUMENT PANELS



| 6 MONTHS Production Lead Time Reduced To 2 MONTHS |

▲ PRODUCTION LEAD TIME INITIALLY ESTABLISHED AT 6 MONTHS UPON ASSUMPTION OF MANAGEMENT RESPONSIBILITY BY DSA IN JULY 1964

▲ SPECIAL STUDY CONDUCTED IN DECEMBER 1964 DETERMINED LEAD TIME COULD BE REDUCED TO 2 MONTHS

QUANTITY REDUCED: 626,740 UNIT PRICE: \$0.31

FY 1965 SAVINGS \$194,289

DEFENSE GENERAL SUPPLY CENTER DSA

SPARROW MISSILES

USED IN AIR-TO-AIR COMBAT ON F-4 AIRCRAFT

AIR FORCE SCHEDULED A BUY
OF 1200 SPARROW MISSILES
IN FY 1965 AT A COST OF
\$32,500 each

- Review of Defense inventory revealed excess Sparrow missiles in Navy stocks
- 1200 transferred to Air Force
- Procurement cancelled

FY 1965 SAVINGS \$39,000,000

Almost always actions which produce savings also lead to more efficient operations and this is clearly reflected in the exceptionally high levels of operational readiness we are now able to maintain for our major weapon systems. In FY 1958, for example, 13% of Air Force aircraft were not fully operational because the necessary spare parts were not in stock. Today only 4% of the aircraft, and 2% of the missiles, are not fully operational because of supply deficiencies. These high readiness levels have been achieved while, at the same time, purchases of spare parts have declined in relation to the value of the weapons in use—during the last four years the value of weapons in use has *increased* by 30% and annual purchases of spare parts have *decreased* by 38%.

	Billions	of Dollars
	FY 1961	FY 1965
Value of Weapons in Operational Use	\$30.9	\$40.3
Purchases of Spare Parts	1.25	.78

B. Increased Use of Excess Inventories

Buying only what we need also means making maximum use of excess stocks already on hand. Inventory managers in all the Services are required to constantly search their stocks—and those of other Services—to try to find the same or a useable substitute for items about to be purchased.

Here are some of the ways in which excess stocks were used in lieu of new procurement during the past year:

1. The Army acquired 236 missile targets which were excess to Air Force needs, saving \$560,700.
2. The Air Force acquired 1,200 SPARROW air-to-air missiles which were excess to the Navy's needs, saving \$39 million.

3. The Navy, instead of buying a three-year supply of supersonic target drones, acquired from the Air Force 125 excess BOMARC air defense missiles. Total savings amounted to \$9.7 million, of which \$3.5 million was realized in FY 1965.
4. The Defense Supply Agency filled a requirement for 920,000 yards of cotton cloth for overcoat linings by using excess stocks of cloth originally purchased for the manufacture of sleeping bag cases. The savings were \$751,649.

USE OF
EXCESS

UTILIZATION OF BOMARC MISSILES

AIR FORCE HAD EXCESS MISSILES RESULTING FROM PHASE
OUT OF BOMARC



- NAVY PLANNED TO PURCHASE SUPERSONIC TARGET DRONES. INSTEAD 125 MISSILES AND RELATED EQUIPMENT TRANSFERRED TO NAVY ON A NON-REIMBURSABLE BASIS.
- THE BOMARC MISSILES WILL BE UTILIZED BY NAVY IN TARGET DRONE PROGRAM AS HIGH SPEED SUPERSONIC TARGETS - PLANS FOR PURCHASE OF NEW DRONES WERE CANCELLED.

FY 1965

SAVINGS \$3,500,000

SAVINGS IN TARGET
DRONE PROCUREMENT IN FY 1964, 1965, 1966 \$9,700,000

C. Eliminating Goldplating

Having ensured that we are buying only the necessary quantities of supplies and equipment, we must also make certain that we do not specify standards of performance, reliability or durability which are higher than those required by the military mission. The systematic techniques used to accomplish this task are known collectively as "value engineering". The true potential of these techniques has become clearer during the past year and I am now confident that savings of as much as \$500 million annually can be realized from this source in FY 1969. This figure compares with a long range goal of \$185 million in savings envisaged last year.

To help assure the realization of this potential, I have recently authorized the hiring of 265 additional full-time value engineering specialists. They will pay for themselves many times over through the savings they achieve. Moreover, by simplifying our weapons and equipment, they will also be contributing to the military effectiveness of the forces. In addition, many of our contracts now provide for the sharing of savings resulting from value engineering improvements proposed by the contractors. As a result, we are now receiving increasing numbers of such proposals and about 470 have been approved through the first nine months of FY 1965.

The following examples are typical of the hundreds of value engineering changes made in FY 1965:

	<u>Unit Cost</u>		<u>Net Savings</u>
	<u>Before Redesign</u>	<u>After Redesign</u>	
1. <i>XM 169 Cartridge Case.</i> Redesigned using simpler manufacturing methods and fewer parts.	\$ 1.15	\$.54	\$1,073,502
2. <i>TERRIER/TARTAR</i> <i>Missile Container.</i> Redesigned using new materials and packaging techniques.	2,000.00	246.57	1,183,565
3. <i>Colored Smoke Rocket, 2.75".</i> Redesigned to reduce production time and improve performance.	31.60	16.56	627,000
4. <i>MINUTEMAN Test Equipment.</i> Redesigned to perform the combined functions of two different devices.	5,715,466	4,086,906	1,628,560
5. <i>Oxygen Canister.</i> Redesigned with fewer parts.	11.32	9.23	266,980

ELIMINATING
GOLDPLATING

MISSILE STOWAGE CRADLE

FUNCTION: HOLD & PROTECT TERRIER/TARTAR MISSILES
ABOARD SHIP AND AT DEPOTS

BEFORE



UNIT COST \$2,000

AFTER



UNIT COST 246.57
PERCENTAGE REDUCTION - 88%

ON 675 UNITS

FY 1965 SAVINGS \$1,183,565

ELIMINATING
GOLDPLATING

2.75 COLORED SMOKE ROCKET

FUNCTION: MARKS TARGETS, LANDING SITES, AERIAL DROP
ZONES AND DANGER AREAS

NEW DESIGN

- BURSTING CHARGE PLACED AROUND DYE-
INSTEAD OF DYE AROUND EXPLOSIVE
- DYE PELLETTED - INSTEAD OF MELTED,
POURED INTO SHELL AND SOLIDIFIED

ADVANTAGES

- DENSER CLOUD
- EQUAL OR BETTER FRAGMENTATION
- LESS HAZARD FROM TOXIC FUMES
- EASIER LOADING
- PRODUCED 65% FASTER

COST PER ROCKET

OLD DESIGN \$31.60

NEW DESIGN \$16.56 - COST REDUCTION 47%

FY 1965

[49,000 UNITS]

2.75 INCH RED MARKER
60 POUND WARHEAD XM152



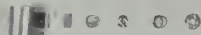
[NET AFTER \$110,000 DEVELOPMENT COST]

ELIMINATING
GOLDPLATING

XM 169 CARTRIDGE CASE

FUNCTION: HOLDS 40MM ROUND USED BY HELICOPTERS FOR AUTOMATIC FIRE

BEFORE



\$1.15 PER UNIT

AFTER



\$0.54 PER UNIT

REDUCED:

- COMPONENT PARTS (FROM 6 TO 3)
- ASSEMBLY TIME
- HANGFIRES
- COSTS (52%)

On 1,758,000 Units FY 1965

SAVINGS
\$1,073,502

ELIMINATING
GOLDPLATING

OXYGEN CANISTER

FUNCTION: PRODUCES BREATHING OXYGEN FOR EMERGENCY USE

COST

\$11.32



CHANGES

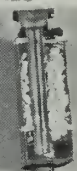
- USE ONE OXYGEN-GENERATING
CANDLE INSTEAD OF TWO
- ELIMINATE CENTER SCREEN
- REDESIGN TOP SCREEN
- ELIMINATE COPPER LINER

RESULTS

- LOWER COSTS
- OPERATIONAL LIFE INCREASED
FROM 375 MINUTES TO
60 MINUTES

COST

\$9.23



CONTRACT SAVINGS ON 35,000 UNITS \$ 73,150
SAVINGS FROM INCREASED OPERATIONAL LIFE 193,830

TOTAL FY 1965 SAVINGS \$266,980

D. *Inventory Item Reduction*

Because every different item in the supply system must be separately stored and accounted for, it is highly important that their number be held to the minimum. Needless proliferation of types, colors, sizes, finishes, etc. in the past has resulted in millions of dollars of unnecessary management and warehousing costs. Moreover, when the very same item is unknowingly given different stock numbers by different logistics agencies, not only are management costs multiplied but duplicate stocks are bought. This problem is now being attacked at several levels:

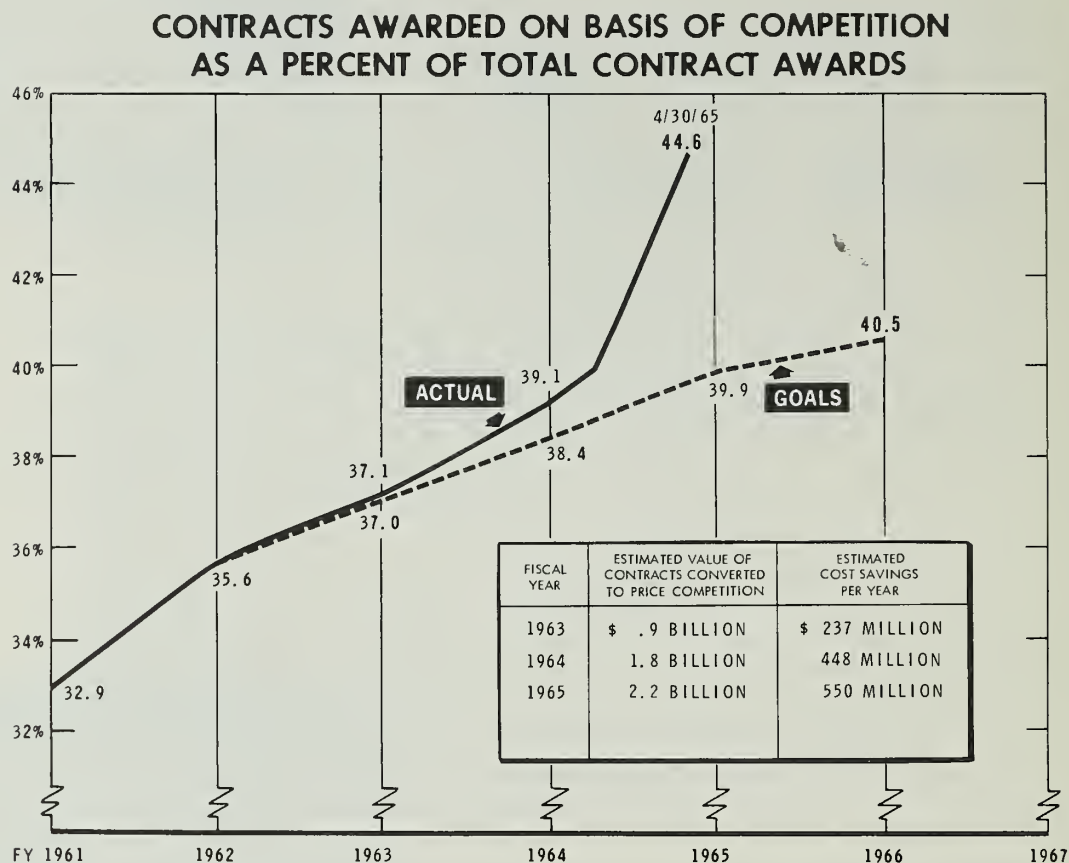
1. *Purging existing inventories of duplicative items.* During the first nine months of FY 1965, over 370,000 items were eliminated.
2. *Controlling the entry of new items.* An automated Item Entry Control System is now helping to prevent duplicate items from entering the inventory. After rising from about 3.4 million at the end of FY 1958 to over 4 million in FY 1962, the number of items in the supply system has been reduced to about 3.9 million.
3. *Limiting the creation of new items through the standardization of components and parts.* We have initiated a standardization program reaching back to the research and development stage since decisions made at that point determine the number of new items which ultimately enter the supply system. Wherever feasible we are now requiring the standardization of parts and components within a single development project. To encourage designers to use existing parts and components, we are improving our data storage and retrieval systems so that the necessary drawings and technical descriptions will be readily available.
4. *Avoiding parallel development projects.* Every time a new weapon enters the inventory, it brings with it literally thousands of new items of spares and support equipment. Nowhere do we have a better opportunity to limit the number of different items in our logistics system than by preventing duplicative weapon developments. An outstanding example is the F-111 aircraft, where logistical support for some 10,000-15,000 parts common to both the Navy and Air Force versions will be provided by the Air Force.

II. BUYING AT THE LOWEST SOUND PRICE

Extraordinary progress has been made during the last four years in improving the effectiveness of our contracting activities. Extensive training programs have been undertaken to raise the skill of our procurement personnel, both military and civilian. Procedures have been streamlined. Specific objectives have been established for our buying offices aimed at obtaining lower procurement costs through two principal improvements: (1) more competitive procurement of military items; and (2) fewer cost-plus-fixed-fee contracts, with greater risk sharing by contractors in the development and production of complex weapons and equipment.

A. Shifting from Non-Competitive to Competitive Procurement

As shown in the chart below, 44.6% of our prime contracts were awarded on the basis of price competition during the first ten months of FY 1965, a sharp increase over the year before and well above our goal for the period. Since 1961 the proportion of contracts awarded competitively has increased by more than one-third.



We estimate that for every dollar shifted from non-competitive to competitive procurement, the net price saving averages in excess of 25 cents. A detailed audit of a sample of contracts awarded competitively for the first time in the first nine months of FY 1965 shows net savings ranging from 11% to 80%, for an average of 36 cents saved on each dollar shifted. In FY 1965 we estimate that this shift to competitive procurement produced savings of over \$550 million. Here are some examples:

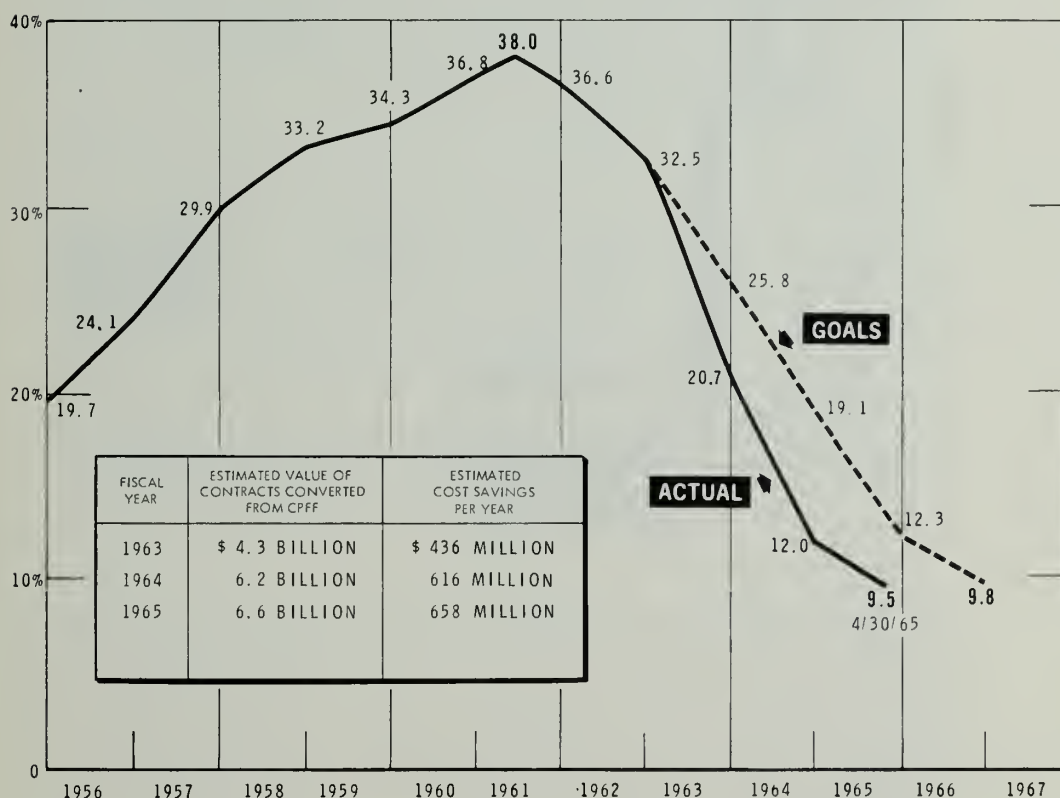
	Non-Competitive Price per Unit	Competitive Price per Unit	Percent Reduction	Savings
1. Radio Set, AN/ARC-54	\$ 4,413.00	\$2,389.00	45	\$3,712,823
2. Generator Set, GED	1,317.54	997.00	24	2,812,715
3. Polaris MK-2, Guidance Electronics Assembly	38,584.00	25,876.00	32	1,672,872
4. AQM-37H Target	18,446.00	13,969.00	24	1,504,419
5. Generator, 30 KVA	1,920.00	818.00	57	1,327,529
6. Cable Clamp	3.01	.61	80	5,160

We are now working on what may prove to be a major breakthrough in our efforts to further increase competitive procurement. We plan to award competitively one contract for both the development and production of the new C-5A transport aircraft. Up to now, it has proved most difficult to avoid sole source procurement of major weapon systems such as missiles or aircraft which require extensive development effort. The development contractor, having already amortized large engineering and tooling costs, usually has such a great advantage in bidding for the production contract that meaningful competition, for all practical purposes, is impossible. Furthermore, in these types of programs, contractors often propose unrealistically low prices on the development phase in the expectation of making their profit on the production contract. Although the C-5A program is particularly suited to this new type of "life cycle" contracting, we may be able to extend this technique to other projects.

B. Shifting from Cost-Plus-Fixed-Fee to Fixed-Price Contracts

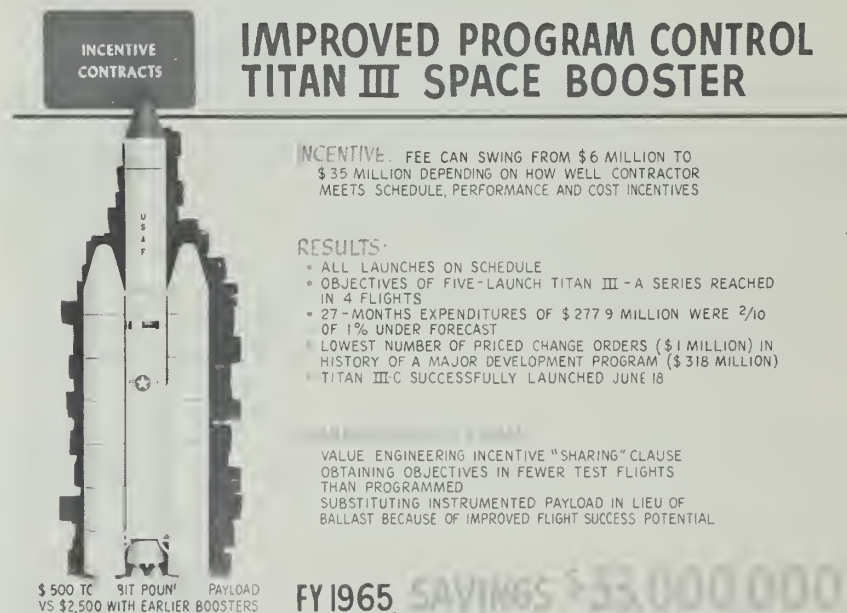
As shown in the chart below, our progress in reducing the use of CPFF contracts has exceeded all expectations. In the first ten months of FY 1965, CPFF contracts amounted to only 9.5 percent of the total, compared with 38 percent in the first nine months of FY 1961. We have now set a new full year goal of 9.8 percent compared with the previous target of 12.3 percent.

COST PLUS FIXED FEE CONTRACTS AS A PERCENT OF TOTAL CONTRACT AWARDS



The CPFF contract is one of the most undesirable forms of Government procurement. The Government is committed to pay automatically all costs plus a guaranteed profit, thus providing neither rewards for good management nor penalties for poor management. Moreover, CPFF contracts allow Defense program managers to undertake large development projects without having done the detailed prior planning that good management practice would require. A recent analysis of 1,526 completed CPFF contracts with a face value of \$4.3 billion shows a cost growth of about 70% above the initial estimates. (Cost over-runs on some CPFF contracts have amounted to as much as three to ten times the initial estimates.) In contrast, 371 completed incentive type contracts with a face value of \$8.7 billion show a cost growth of only 10%. An outstanding example is the TITAN III C space booster, which was launched with such great success on June 18. Costs to the Government under this incentive contract are running two-tenths of 1% below forecast after 27 months of operation.

Our analyses indicate that at least ten cents is saved on each dollar shifted from CPFF to some other form of contract. These savings are realized progressively over a period of years, as the work is actually completed. Assuming an average lag of two years, savings realized in FY 1965 from this source should total \$436 million and should continue to grow in succeeding years.



C. Multi-year Procurement

Last year I informed you that we had begun to use multi-year competitive contracts for major items for which we have firm requirements extending over two or more years. This type of contract produces additional savings by avoiding annual "start up" costs and by giving bidders an incentive to offer lower prices based on the larger production quantities. Savings from this source amounted to \$56 million in FY 1965. Here are some examples:

	Unit Price		Percent Reduction	Total Savings
	Single year	Multi-year		
1. Generator, 10 KW, 60 Cy	\$1,198.00	\$ 997.00	16	\$1,758,540
2. Multiple Time Fuse Assembly	14.10	13.38	5	281,880
3. Major Components for BULLPUP Missiles	1,605.00	1,494.00	7	444,167
4. Bomb Rack Ejector	1,313.10	534.00	59	2,786,840
5. Receiver Set, R-1051/URR	2,500.00	1,708.00	32	1,755,864

PRICE COMPETITION

MULTIPLE TIME FUSE ASSEMBLY M585

FUNCTION USED TO DETONATE ARTILLERY AMMUNITION

OLD METHOD

FORMERLY PROCURED THRU SINGLE YEAR COMPETITIVE PROCUREMENT

LOWEST UNIT PRICE BID

\$14.10

FIRST YEAR MULTI-YEAR
BUY FOR ARMY:
365,000 UNITS

ARMY SAVINGS
\$262,800

TOTAL FY1965

NEW METHOD

NOW PROCURED THRU MULTI-YEAR (3 YRS) COMPETITIVE PROCUREMENT

LOWEST UNIT PRICE BID

\$13.38

FIRST YEAR MULTI-YEAR
BUY FOR MARINE CORPS:
26,500 UNITS

MARINE CORPS SAVINGS
\$19,080

M585 MULTIPLE TIME FUSE ASSEMBLY

(ARMY & MARINE CORPS) **\$281,880**



MULTI-YEAR PROCUREMENT

BOMB RACK EJECTOR

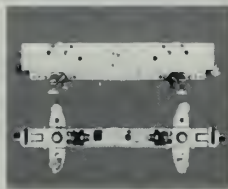
FUNCTION: TO EJECT BOMBS FROM USAF FIGHTER AIRCRAFT.
USED ON F-4C, F-4D, F-105 AND F-111.

MULTI-YEAR PROCUREMENT

GENERATES COMPETITION THAT IS OTHERWISE UNOBTAINABLE BECAUSE OF HIGH START-UP AND CAPITAL INVESTMENT COSTS INVOLVED IN THE INITIAL PRODUCTION OF CERTAIN ITEMS.

BUY ON A MULTI-YEAR RATHER THAN A SINGLE YEAR BASIS WHEN:

- DESIGN IS STABLE.
- MULTI-YEAR REQUIREMENTS ARE KNOWN.



FY1963

COMPETITIVELY PROCURED

Single Year
Unit Price
\$1,523.00

FY1965

Low Single Year Unit Price Bid **\$1,313.10**
Multi-Year Unit Price Awarded **534.00**

Number Procured in FY 1965 **x 3,577**

FY 1965

TOTAL SAVINGS \$2,786,840

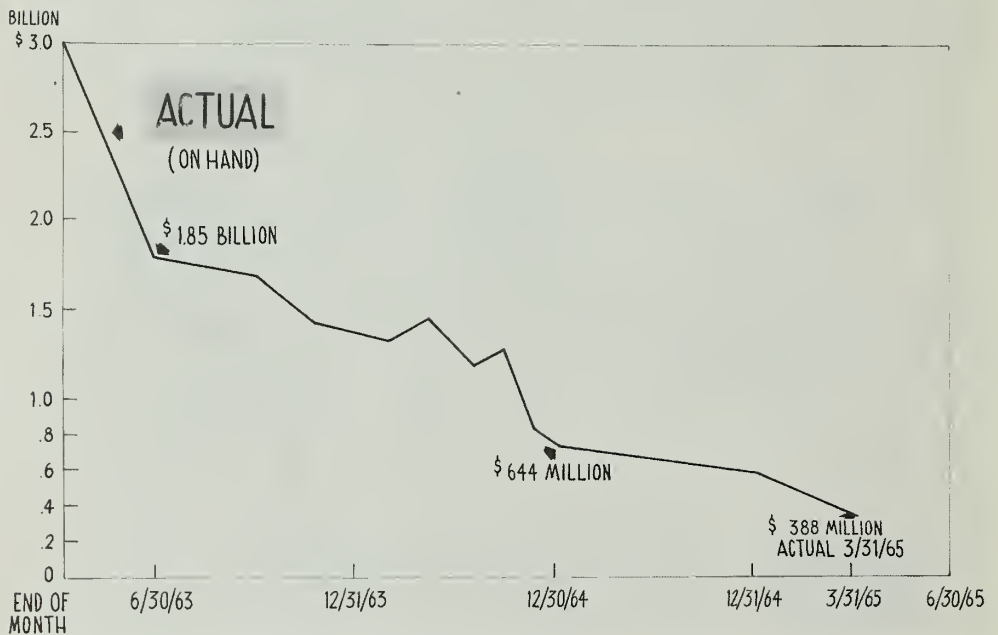


AERONAUTICAL SYSTEMS DIV.

D. Letter Contracts

Another major improvement in our procurement practices is reflected in the drastic reduction in the value of "letter" contracts outstanding—from \$2.9 billion on March 31, 1963 to less than \$0.4 billion on March 31, 1965—with most of the reduction achieved during the past year. A letter contract authorizes a contractor to start work, guaranteeing him full reimbursement for all costs incurred, before the price or even the precise scope of the project is agreed upon. Since the Government bears the full risk up to the amount actually obligated on the contract, the contractor is given no positive incentive to manage the work efficiently. The use of letter contracts is now restricted to emergency situations where no other form of contract is suitable, and when they are used, we are insisting that they be converted to a permanent form in a timely manner.

LETTER CONTRACTS



E. Industry Participation in the Cost Reduction Program

When we buy for less, our contractors obviously sell for less. To do so, and still make a profit, they must reduce their costs. We have now received the first semi-annual cost reduction progress reports from 68 of the major prime contractors who, in response to your request a year and a half ago, agreed to participate in the program. Since many of these prime contractors also subcontract to each other, the aggregate savings reported include some undetermined amount of duplication. Nevertheless, it is clear that these contractors have achieved several hundred million dollars of savings in the first six-month reporting period. We have just published a pamphlet containing 128 examples of such cost reduction actions, drawn from the more than 700 displayed by contractors at the joint Defense-Industry meetings which were held in five major cities around the country in March and April.

In this connection, I was very pleased to learn that one of our largest contractors has succeeded in reducing CPFF purchasing by its Missile and Space Division from 56% of total purchases in CY 1963 to 9% in CY 1964. This is not surprising since the contractor's sales to the Government have shifted from 73.7% CPFF in 1961 to 17.7% in 1964. With regard to competition, a recent Air Force study of thirty major Defense contractors indicates that they have increased their competitive purchasing of materiel from 46% of total purchases in 1963 to 52% in 1964.

III. REDUCING OPERATING COSTS

The third part of the Cost Reduction Program comprises our efforts to increase the efficiency of our day-to-day operations in the supply, maintenance, communications, transportation and general administrative areas. These efforts produced savings of over \$1 billion in FY 1965, a figure which I believe can be raised to \$2.2 billion by FY 1969 and each year thereafter.

A. *Terminating Unnecessary Operations*

Because the Defense program is greatly influenced by changes in the international situation and in military technology, frequent, and at times, drastic shifts in requirements for weapons, manpower and facilities cannot be avoided. Even while we have been steadily increasing our military strength over the last four years, many existing military installations have become surplus to all foreseeable peacetime and wartime needs. These facilities must be closed if the Defense program is to be managed efficiently and waste eliminated.

Accordingly, we have continued our detailed review of the nearly 13,000 major and minor Defense installations around the world. During the fiscal year just ended, another 129 Defense activities were selected to be closed, reduced in scope or consolidated—with an ultimate recurring saving to the taxpayer of \$457 million each year. As shown below, these closings, when completed, will almost double the annual savings—to more than \$1 billion a year. (Savings actually realized in FY 1965 totaled \$483 million.)

	Total Through 30 June 1964	Total Through 30 June 1965	Increase
Number of Actions	574	703	129
Real Estate Released (acres)	1,083,978	1,630,630	546,652
Industrial Plants with Commercial Potential Made Available for Sale	61	64	3
Job Positions Eliminated	85,834	147,801	61,967
Annual Operating Savings	\$577 Mil.	\$1,034 Mil.	\$457 Mil.

While these savings are impressive in themselves, the closing of surplus military facilities promises an even more important benefit to our Nation. Valuable resources which would otherwise remain idle, or be underutilized, are thereby freed for more productive purposes. If wisely used, they can make a significant contribution to the economic and social welfare of our people, and particularly to the communities in which they are located. We recognize, of course, that during the period of transition, the welfare of the communities involved, as well as the employees of these facilities, may be seriously affected. But they need not and should not be forced to carry this burden unaided. Both in fairness to the people affected and in the interest of the efficient management of the Defense program, the Government should help ease the process of adjustment.

Last year, you reaffirmed the Government's acceptance of this responsibility and you called for the full mobilization of our resources in support of the readjustment effort. The booklet enclosed with this memorandum describes how the Defense Department, assisted by other Government Agencies, is carrying out this responsibility—how new job opportunities are being found for displaced Defense employees and how many communities are actually improving their economic and social well-being through new uses of surplus military facilities.

B. Consolidation and Standardization of Operations

Significant operating economies, usually accompanied by increases in efficiency, can often be obtained when common support activities are consolidated. During the past year we have continued to seek out such opportunities, and to improve the operating procedures of the Department as a whole.

The consolidation of common supplies and services in the Defense Supply Agency continues to yield impressive savings. In its three and a half years of existence, DSA has reduced annual operating costs by \$58 million, reduced inventories by \$506 million and reduced personnel by 7,871.

As reported to you last year, we are presently consolidating under a single management the 150 offices and 20,000 people involved in the administration of contracts after their award. This action should be completed by next July, eliminating about 1,800 jobs and producing savings of about \$19 million annually.

In a related move, we have now established a Defense Contract Audit Agency which will bring under one management the audit activities previously performed by some 3,400 people in 268 offices of the three military departments. As many as forty of these offices will be eliminated with an overall job saving of five percent, when this Agency becomes fully operational a year from now.

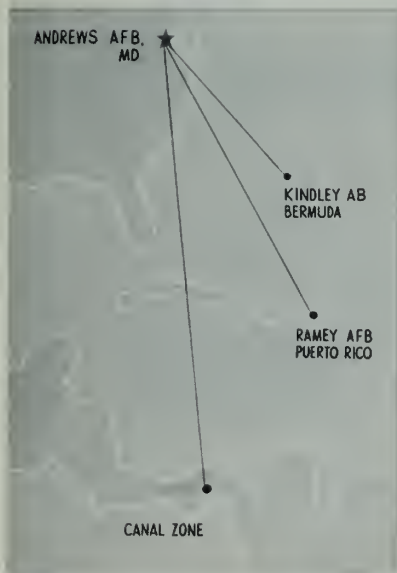
C. Increasing Operating Efficiency in Other Support Functions

1. *Communications Systems Costs*—Through the consolidation and integration of leased long-line communications, the elimination of unneeded circuits and equipment, and other economies, \$108 million was saved in FY 1965.

2. *Transportation and Traffic Management*—By using lower cost means of passenger travel, of cargo transportation, of household goods shipments and of overseas mail service, \$28 million in savings were realized in FY 1965.

INCREASING
EFFICIENCY
OF OPERATIONS

COMMERCIAL COMMUNICATION CIRCUITS DISCONTINUED



BEFORE

CONTINENTAL UNITED STATES
AUTOMATIC DIGITAL NETWORK
WAS EXTENDED TO 3 OVERSEAS
BASES FROM ANDREWS AFB
BY LEASED COMMERCIAL
CIRCUITS

MONTHLY
COST

\$ 33,346

AFTER

ANALYSIS DETERMINED THAT
EXISTING DOD CIRCUITS AFTER
CONVERSION OF ONE TO A TELE-
TYPE DATA LINE SATISFIED
ALL COMMUNICATION REQUIRE-
MENTS. COMMERCIAL CIRCUITS
DISCONTINUED

NEW COST \$ 4,652

FY 1965
SAVINGS
(11 MONTHS)

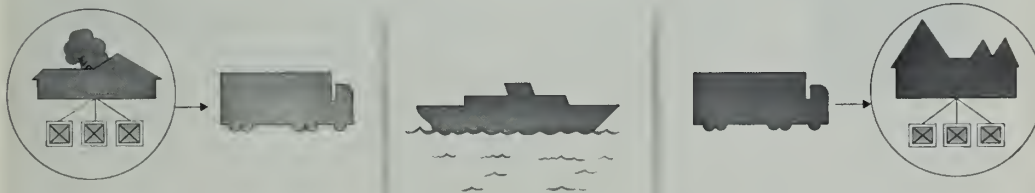
\$315,600



INCREASING
EFFICIENCY
OF OPERATIONS

IMPROVED TRANSPORTATION & TRAFFIC MANAGEMENT

THRU-BILL OF LADING SHIPMENTS OF HOUSEHOLD GOODS



USE OF CONTAINERIZED DOOR-TO-DOOR SERVICE BILLED
ON A SINGLE DOCUMENT SAVED THE DEPT. OF DEFENSE:

FY 1965 SAVINGS
(thru 3rd QTR) **\$12,900,000⁰⁰**



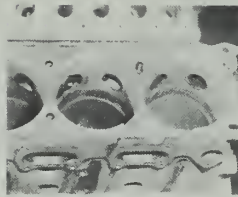
3. *Maintenance Management*—By consolidating maintenance activities, by eliminating unnecessary maintenance requirements, by seeking out rebuild opportunities in place of new procurement, by better scheduling and by improved maintenance manning standards, we realized savings of \$97 million in FY 1965.

INCREASING
EFFICIENCY
OF OPERATIONS

REPAIR OF ALUMINUM ENGINE BLOCK

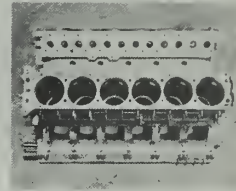
USED IN MINE SWEEPING AND HUNTING VESSELS

BEFORE



DEFECTIVE ALUMINUM BLOCKS WERE SCRAPPED
AND NEW BLOCKS PURCHASED AT A COST
RANGING FROM \$6,170 TO \$20,910 PER BLOCK

AFTER



EXPERIMENTS SHOWED THAT DEFECTIVE ALUMINUM BLOCKS
COULD BE CLEANED, GROUND SMOOTH, WELDED, MACHINED AND
INSPECTED AT AN AVERAGE COST OF \$504 PER BLOCK

FY 1965 SAVINGS **\$193,667**

4. *Other*—By raising the operating efficiency of our non-combat vehicle fleet, by reducing the use of contract technicians, by improving the management of military housing and other real property and by a variety of other actions, savings of \$147 million were realized last year.

INCREASING
EFFICIENCY
OF OPERATIONS

CONTRACT TECHNICAL ASSISTANCE

ENTER: WAVE AIRCRAFT



HU1B IROQUOIS

ENTER: WAVE AIRCRAFT



CV2B CARIBOU

CONTRACT TECHNICIANS FOR AERONAUTICAL EQUIPMENT

- RADAR
- RADIO
- PHOTO
- NAVIGATION
- OTHER AVIONICS

21 REPLACED BY CIVIL
SERVICE EMPLOYEES
SAVINGS \$19

29 ELIMINATED WITHOUT
REPLACEMENT
SAVINGS \$1,000,000

FY 1965 SAVINGS **\$472,799**

REDUCTION IN VACANCY LOSSES

PRE-VACATE INSPECTION



ONE STOP REFURBISHING



IMPROVE MOVE-IN SCHEDULING



REDUCING HOUSING TURNOVER TIME SAVES BASIC ALLOWANCE FOR QUARTERS
VACANCY LOSSES REDUCED FROM 2,008,548 DAYS IN
FY 1962 TO 800,000 DAYS IN FY 1965.
1,208,548 DAYS \$2.58 AVERAGE BAQ PER DAY

FY 1965 SAVINGS \$3.1 MILLION

IV. SUMMARY

The results of the Defense Department Cost Reduction Program, now in its fourth year of operation, have far surpassed our most optimistic expectations at the time of its launching in 1962. It has permeated all levels of management in the Defense Department and is now widely accepted by all levels of management in Defense industry. This is a most important development since the success of the Program depends to a great extent upon the understanding and active support of the people who must actually do the job. It is at the working level where new opportunities for cost savings can be seen most clearly.

With the many improvements in logistics organization, policies and procedures already achieved, the possibilities for further large gains in these areas are gradually narrowing. The "Refining of Requirements Calculations", which accounted for \$2.1 billion of the \$4.6 billion savings realized in FY 1965, has been pretty well exploited. Although we have still to obtain the full amount of savings resulting from the shift away from CPFF contracts, the entire contracting area has also been substantially exploited. We do expect to make further important gains from the increased utilization of excess inventories, the expanded "value engineering" program, and the reduction of operating costs. It is mainly from our efforts in these three areas that we expect to raise our realized savings from \$4.6 billion in FY 1965 to \$6.1 billion by FY 1969 and each year thereafter.

ROBERT S. McNAMARA

REMARKS OF THE PRESIDENT AT THE COST REDUCTION AWARDS
CEREMONY, THE PENTAGON, JULY 28, 1965

Secretary McNamara, Secretary Vance, Service Secretaries, General Wheeler, Members of the Joint Chiefs, very valued employees to the Government of the United States:

I always come here to the Pentagon with a great sense of pride and a deep sense of gratitude. As a citizen, not as Commander-in-Chief, I am both proud and grateful for all of you who serve our country with such dedication—military and civilian alike . . .

A great deal has happened since I had the pleasure of coming and visiting with you here about a year ago. Among the many good things which have occurred, are the benefits that we enjoy from the results of your labors and the savings and cost reduction actions that the Defense Department has taken. As a result of those achievements, our military strength has continued to increase faster than our Defense budget, and that is as it should be.

Last January, I told the Congress, and I quote: "Defense expenditures in the years ahead must continue to be guided by the relentless pursuit of efficiency and intelligent economy. There is no necessary conflict between the need for a strong defense and the principles of economy and sound management. And if we are to remain strong—outmoded weapons must be replaced by new ones; obsolete equipment and installations must be eliminated; costly duplication of effort must be eliminated."

We're following this policy today, and so long as I'm President I intend to continue to follow that policy. But, I think I should tell you that I could not follow it successfully, and Secretary McNamara could not follow it at all, without your loyal and your energetic and your imaginative efforts.

So I have come here this morning, first to thank you, and second, to congratulate you.

Secretary McNamara's report to me a few days ago tells an impressive story about your achievements. In the fiscal year 1964 you saved some \$2.8 billion; last year you nearly doubled that amount. In fact, your actual savings of \$4.6 billion for fiscal year 1965 were actually \$2.1 billion more than he originally estimated. Now, this is a record of which all of you can be proud, and for which this country can be proud of you, and grateful to you.

But there's a good deal more to that story. You have proved the truth of my assurance to Congress that economy and efficiency can go hand in hand with a strong defense. For, side by side with our cost reduction measures, our military strength has continued to mount. Secretary McNamara reports to me that in the past 4 years you have achieved the following:

First, a 200 percent increase in the number of nuclear warheads and total megatonnage of nuclear weapons in the Strategic Alert Forces.

Second, a 67 percent increase in the tactical nuclear weapons deployed in Western Europe.

Third, a 45 percent increase in the number of combat-ready Army divisions.

Fourth, a 51 percent increase in the number of Air Force tactical fighter squadrons.

Fifth, a 100 percent increase in airlift capability.

Sixth, a 100 percent increase in Naval ship construction and conversion to modernize our fleet.

Seventh, a 1,000 percent increase in the Special Forces that are trained for counterinsurgency.

Now, without this magnificent record, we would be very ill-equipped to meet the situation that we've encountered in Viet-Nam, or the many other worldwide commitments that we have to the cause of peace and freedom.

I have just finished reviewing with the leading Members of Congress, the Chairmen of the House and Senate committees, the problems that face America and the world. And today, the future of the whole society of free men depends to a very large extent upon the strength that you have built. You and your colleagues in the Defense Department are the men and women to whom America looks to provide our strength. And you are providing it.

So long as I am permitted to be your President, we will continue to spend whatever it is necessary to spend for the security of our people. We shall continue to maintain our military forces without regard to arbitrary budget ceilings. And with your continued help, we will proceed to procure those forces always at the lowest possible cost. We will continue to operate them with the greatest possible economy and efficiency.

The first week I was in this Office, I promised the people of this Nation that the country would get a dollar's worth of defense for every dollar spent. I wish to thank you for helping me to fulfill that promise.

We have 10 important departments in this Government. We have dozens of outstanding independent agencies that number their employees among the thousands, but I am proud this morning to acknowledge that you are the pace-setters; you are not only the leaders in protecting this Nation's security, but you are the leaders in protecting this Nation's solvency. And the work that the generals, and the admirals, and the secretaries and the stenographers have done together by finding areas of agreement and uniting and following enlightened, cost-conscious 20th century practices, is now being emulated in every single department in this Government.

I've been a Government employee all of my adult life, 35 years. I know the pride that they take in their work and in their country. No person that ever served in uniform or ever served the men in uniform, has more right to feel proud than those who are part of the Defense establishment today. Both in uniform and out, you have men of the highest caliber, of the highest integrity, of the greatest qualities of intelligence and dedication and leadership. I'm proud of our Joint Chiefs of Staff. I'm proud of their counsellors. I'm proud of our Service Secretaries and their assistants and their associates, and I need not tell you how grateful I am for the sacrifice that you Americans are willing to make in order to continue to keep this the home of the brave, and the land of the free.

In the days ahead we will face many trying moments. We will go through many periods when our authority and our position and our system will be challenged, but, under the leadership of what this building houses, we will meet every challenge. We will respond to every challenge and we will, God willing, bring to all the peoples of all the world, peace and progress.

Thank all of you so much.

MR. JOHN A. BOHN
 City Attorney
 Benicia, California



MR. ALBERT A. GROSS
 Naval Research Laboratory
 Washington, D. C.



RECIPIENTS OF THE COST REDUCTION AWARDS

PRESENTED AT THE PENTAGON BY

LYNDON B. JOHNSON
 PRESIDENT OF THE UNITED STATES
 JULY 28, 1965



MR. ROBERT E. TURNER
 Ogden Air Materiel Area
 Ogden, Utah



MR. MORTON MEMBERG
 Defense Supply Agency
 Philadelphia, Pennsylvania



MRS. HAZEL S. HANBACK
 Bureau of Yards & Docks
 Washington, D. C.



SFC JOHN L. LARUE
 U. S. Training Center
 Fort Knox, Kentucky



BRIG. GEN. JOSEPH S. BLEYMAIER
 Space Systems - Manned Systems
 Los Angeles, California



MR. CHARLES D. EDMUNDS, JR.
 Pearl Harbor Naval Shipyard
 Hawaii



SP-5 BERNARD W. A. KLIEM
 Picatinny Arsenal
 New Jersey (Dover)



LT. RAYMOND W. YOUNMANS
 Naval Ordnance Plant
 Louisville, Kentucky



MR. GERALD SMITH
 Defense Supply Agency
 Philadelphia, Pennsylvania



MR. ADOLPH A. WRNKA
 Picatinny Arsenal
 Dover, New Jersey



MR. HAROLD E. HOFFMAN
 Ships Parts Control Center
 Mechanicsburg, Pennsylvania



MR. BENEDICT J. CONIE
 Ogden Air Materiel Area
 Ogden, Utah



MR. ROBERT F. CANNY
 Ogden Air Materiel Area
 Ogden, Utah



MR. EUGENE L. SIMPSON
 Ammunition Procurement & Supply Agency
 Joliet, Illinois



M/SGT LEROY GUGEL
 Dover Air Force Base
 Dover, Delaware